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Connecting Markets East & West

Japan in the World

Economic Outlook for 2025:
Economic Growth Amid Political Divides

January 2025

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Mr. Trump's economic and trade policies

Higher tariffs	Tariffs are indirect taxes. If, say, the US were to impose high tariffs on Chinese imports, the tax costs would be borne by American consumers and businesses in the form of higher prices (which, according to Mr. Trump's thinking, would cause them to favor US-made products and strengthen domestic industry). A tariff increase would more likely **have an inflationary effect on US prices and act as a suppressing force on the country's economy**
Continuation of tax cuts	The underlying legislation of the income tax breaks that are currently in force is the Tax Cuts and Jobs Act, which is set to expire at the end of 2025. Mr. Trump has indicated that he intends to extend this law. **While observers acknowledge that this will help drive the economy, they also believe it will contribute to inflation**
Deportation of undocumented immigrants	In November 2024, the non-profit American Immigration Council estimated that, if US authorities were to deport one million undocumented immigrants every year, the total cost of removing all such immigrants—of which there are estimated to be 13.3 million—would add up to $967.9 billion over a period of more than a decade. This amount is equivalent to around 145 trillion JPY, a figure that exceeds Japan's annual national budget. Given the enormity of this cost, Mr. Trump's mass deportation policy faces significant financial hurdles. However, if the president-elect does push through with the plan, **the resulting erosion of labor supply would create inflationary concerns, while the decrease in immigrant consumption could have an adverse effect on the economy**
Anti-decarbonization	One of the catchphrases Mr. Trump used in his 2024 campaign was "drill, baby, drill" (in reference to fossil fuel), a slogan that was first deployed by Republicans during the 2008 presidential election. This phrase is emblematic of the president-elect's views on decarbonization. His apparent position is that **the increased production of fossil fuels will help stave off inflation, but it is hard to say at this point how true this will be**

The World Economy in 2025:
Ten Major Risks

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Ten major risks identified by Nomura for 2025

Full-scale trade war	Compared to Mr. Trump's first four years, America's trading partners are better prepared now to institute retaliatory measures against any tariff hikes the president-elect might impose, increasing the speed with which things might escalate into a tit-for-tat contest or even a trade war between the US and China or the US and Europe
New round of rate hikes by the Federal Reserve	Given how close the actual growth of the US economy has been to its potential growth rate, the president-elect's America First policies could spark off another surge in inflation. If the Federal Reserve responds to this by lifting interest rates, it risks causing major turmoil in financial markets
Geopolitical conflicts	If Mr. Trump insists on reaching a deal on either of the two major ongoing world conflicts (in Russia/Ukraine and the Middle East), without regard for the negotiation process, a few missteps might be enough to send the situation over the edge and cause geopolitical tensions to spiral out of control
Recovery of the Chinese economy	Mr. Trump's proposed 60% tariff on Chinese-made goods may trigger large-scale public spending by Beijing and increase domestic demand in the Asian country. This could offset some of the downside risks its exports face if the tariff is instituted
Global debt crisis	The global rise in populist leaders strongly suggests that governments will maintain large fiscal deficits even as they incur high levels of debt. If the market starts to question the financial sustainability of these policies, interest rates may surge, triggering another market crisis

The AI boom	2025 will be a critical year for AI, as the implementation of AI applications by businesses becomes a global phenomenon. The resulting productivity increases and massive investments by leading IT players could inspire optimism about ROIs
The death of the AI boom	The perceived downsides of AI—such as their massive energy requirements, their role as cyber threat drivers, their biased algorithms, data privacy concerns, and unease over their impact on human employment—could generate greater backlash
Long-term decline of crude oil prices	The US may increase its production and export of oil to stave off the inflation caused by its tariffs. With demand for crude oil decreasing worldwide, prices could fall below $50 per barrel and enhance the country's advantage over other oil-producing nations
Cyber threats	Geopolitical tensions, the increased prevalence of digital technology, and growing sophistication of cyber-attacks could increase the damage they cause, inflicting catastrophic disruptions on financial systems and other global economic infrastructures
Central banks losing their independence	With populist leaders emerging amidst rising public debt, central banks could come under pressure to lower the cost of borrowing by governments (by decreasing the yields on sovereign bonds). This would cause public debt to balloon further

Japan in 2024:

Seven areas where Japan improved or advanced

1. Continued **price hikes**
2. Continued **wage hikes**
3. **Rate hikes** finally beginning

Three types of "hikes"

4. Increasing **software investment**
5. Increasing **labor mobility**
6. Strengthening **corporate governance** that originated from a request by the Tokyo Stock Exchange (TSE) in 2023 that companies, particularly those with P/B multiples below 1, focus more on capital costs and share prices
7. **Diversification of household financial assets** and **more broad-based provision of risk-tolerant money** with the introduction of the new Nippon Individual Saving Accounts (NISA)

Japan in 2025: Headed towards a "normal" economy with three types of hikes

Japan in 2025

This would cause households to:
(1) become more aggressive spenders
(2) increase their appetite for risk

Price hikes (4th year)

Wage hikes (3rd year)

Rate hikes (2nd year)

Three types of "hikes" more embedded

Headed towards a "normal" economy !

Capex (1):
Companies including SMEs have firm plans for capex

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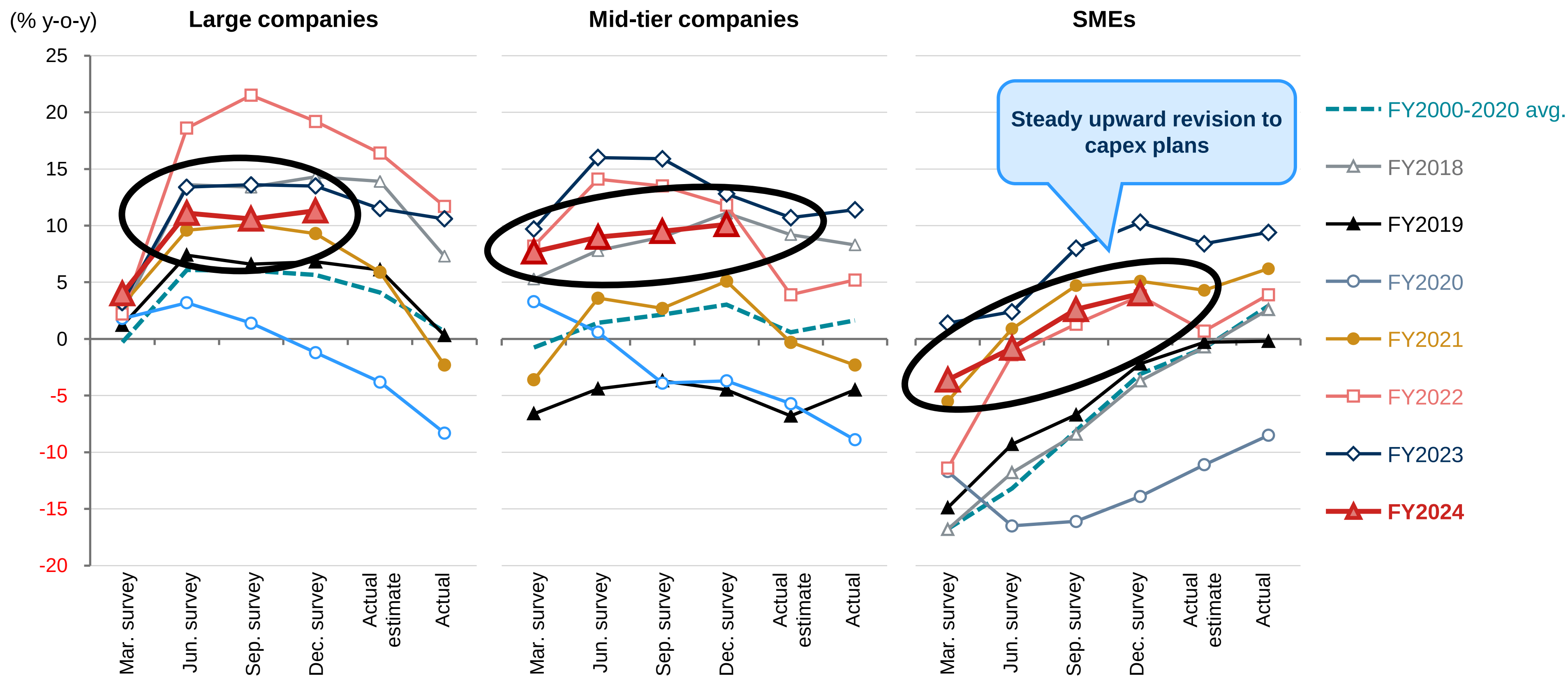
- The BOJ's Tankan survey indicates that FY2024 got off to a good start in terms of companies' capital investment plans
- The main drivers of these investments were digitalization, green transformation, and labor-saving improvements
- That said, whether these plans can seamlessly translate into tangible results is a separate matter entirely

Signs of firm capex in FY24 in companies' plans



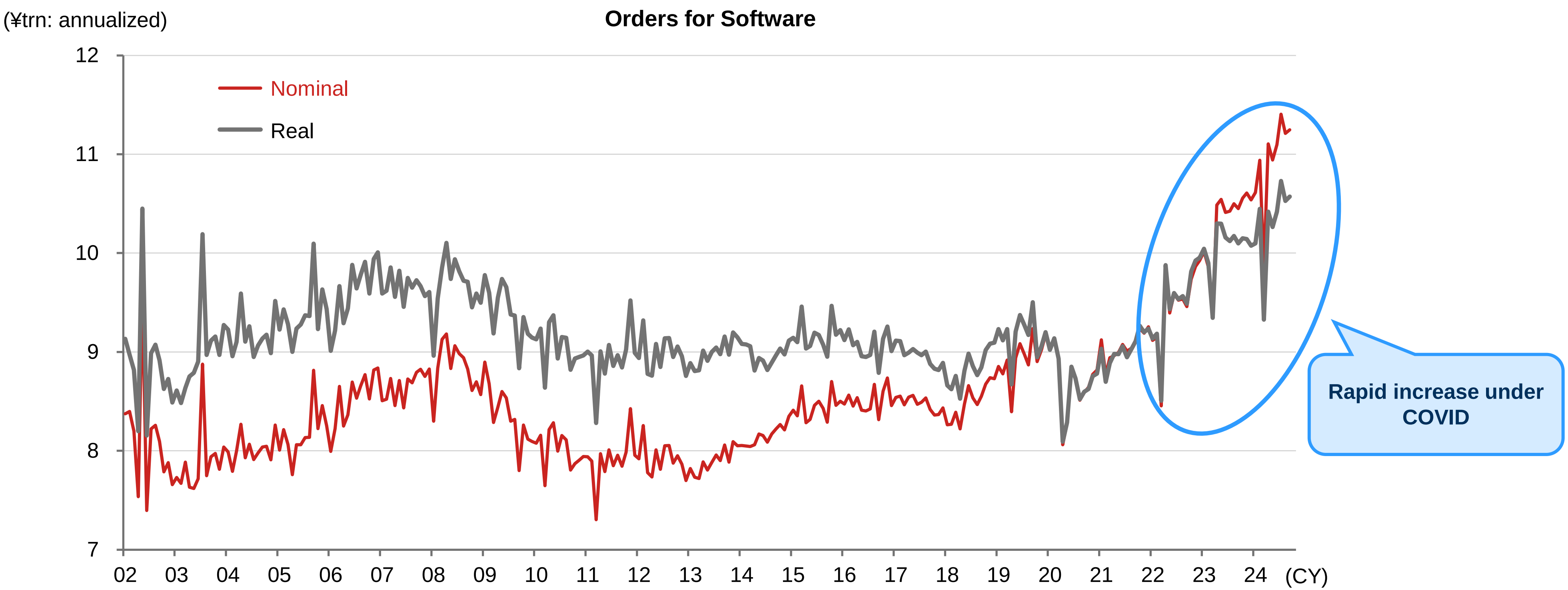
Notes: 1. Capex in these figures includes land but excludes software and R&D.
2. Months on horizontal axis indicate month when survey was carried out. FY-end indicates estimated capex in FY as of FY-end.

Source: BOJ, Nomura

Capex (2): Improvement to Labor Productivity Has Finally Become a Viable Topic of Debate

- **While capex in machinery and construction faces constraints on the supply side (shortages of labor, parts, and materials, and a resulting rise in costs), investments in software have been rising, suggesting that businesses are increasingly adapting to digitalization**

Rapid increase in orders for software (or software investment)



Note: 'Real' orders for software are deflated using prices of custom software (except embedded software) on an SPPI (Service Producer Price Index) basis.
Source: METI, Nomura

Wages (1): Year-Over-Year Real Wage Growth Is Finally Starting to Turn Positive

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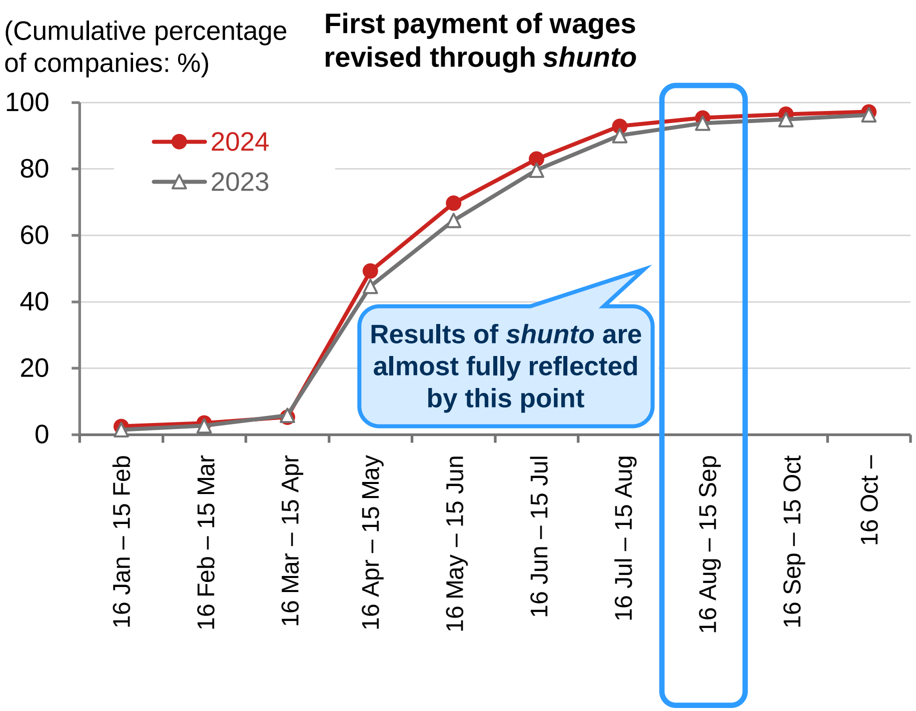
- According to research by the Ministry of Health, Labour and Welfare (MHLW), the outcome of annual wage negotiations (shunto) are usually reflected in workers' pay by the time August salaries are paid
- Thanks to an increase in summer bonuses, June and July 2024 wages saw a YoY gain in both nominal and real terms for the first time in around two years
  ⇒ Due to the one-time nature of bonuses, the YoY gain in real wages largely went away in August. However, this still represents a meaningful improvement over the pre-June months, when YoY growth was well in negative territory

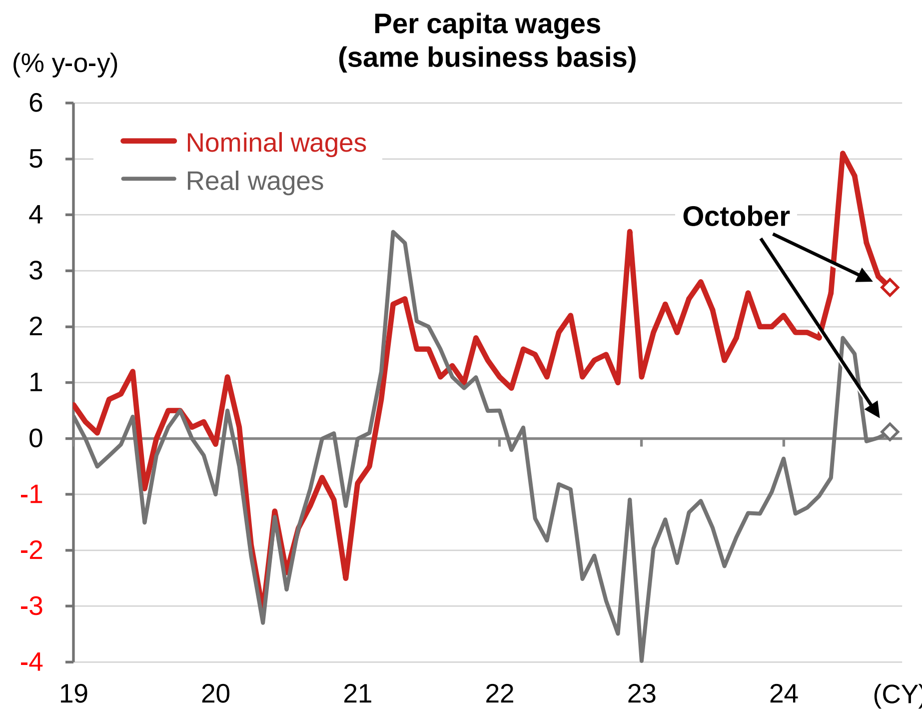
Results of *shunto* (spring wage negotiations) have mostly been reflected by the time August salaries are paid



Note: *Periods on the horizontal axis indicate periods when wages are paid to which companies apply the results of shunto (spring wage negotiations) for the first time in each year.*

Source: MHLW, Nomura

YoY real wage growth is finally starting to turn positive



Note: *1. "Same-business basis" indicates that the sample for year-on-year comparison is the same.*
2. Real wages = nominal wages / CPI (excluding homeowners' imputed rent)

Source: MHLW, MIC, Nomura

Wages (2):
Rengo demands "5% or above" again for 2025 shunto

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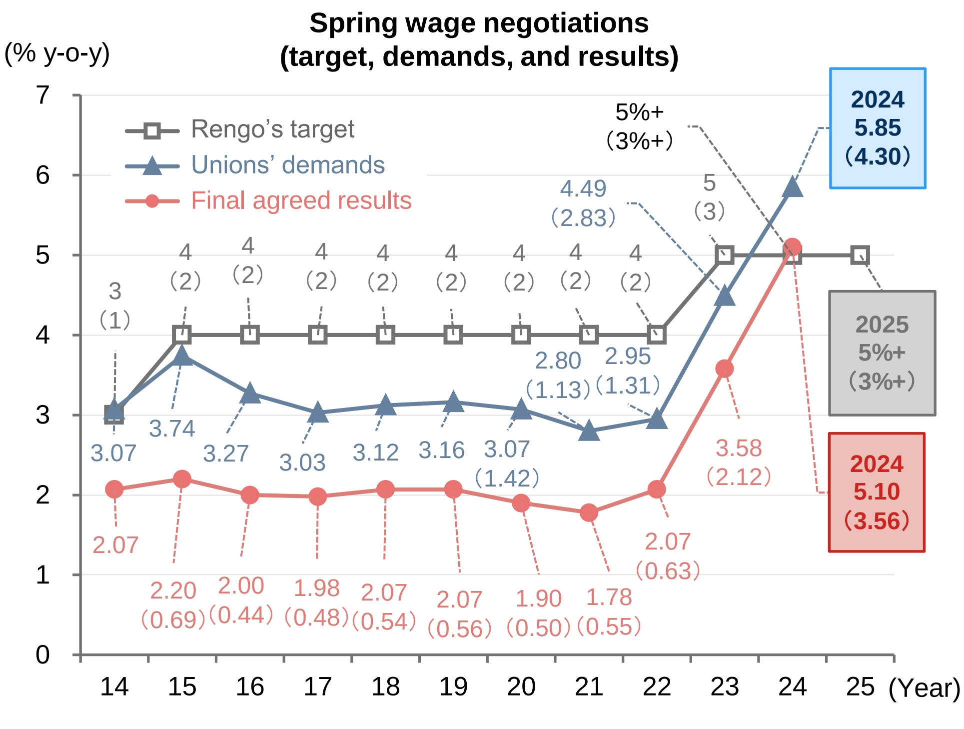
- **Rengo plans to demand wage hikes of "5% or more" (including seniority) and base pay growth of "3% or more" in the 2025 shunto, the same demand as in the 2024 shunto.**
  ⇒ A virtuous cycle between wages and prices will be more likely.
- **Wage hikes are becoming more synchronized among companies, leading to a change in the corporate "norm" about wage hikes.**

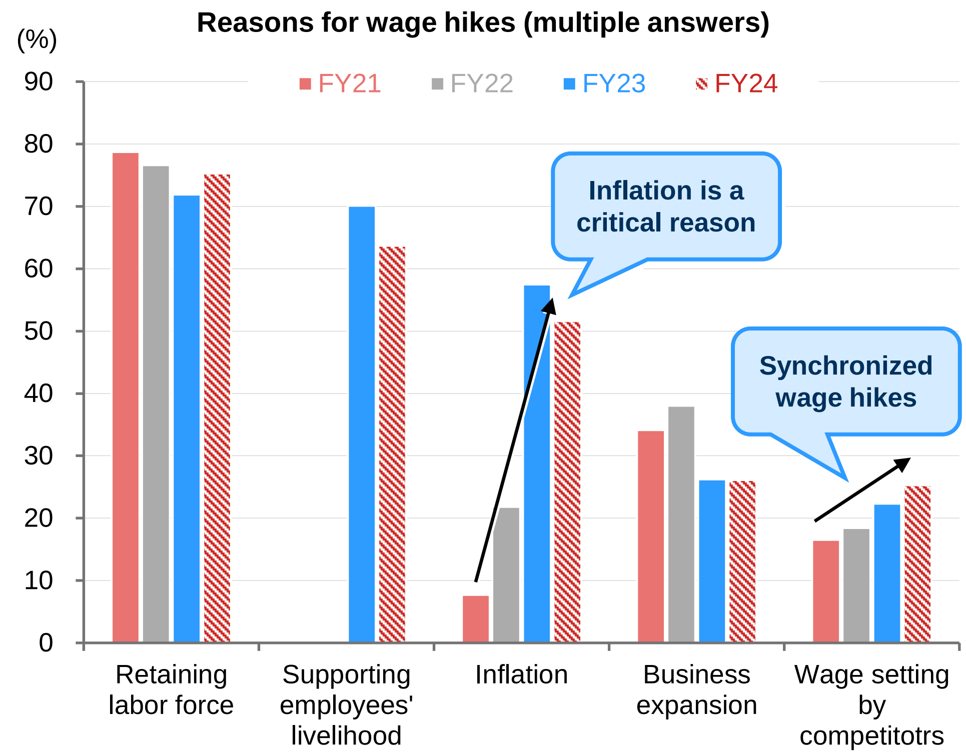
Rengo to demand "5% or above" again for 2025 *shunto*



Note: 1. Based on data of unions that published figures for base pay increase.
2. Figures not in parentheses show total increase in base pay and seniority-based pay. Base pay increase is shown in parentheses.
3. Figures are based on the final set of results of each year's shunto, except for 2025, which shows the Rengo target based on the organization's basic concept.

Source: Nomura, based on Japanese Trade Union Confederation (Rengo) data

More synchronized wage hikes, suggesting a change in the corporate "norm" of wage hikes



Noe: The survey period for FY24 was 18-31 January 2024. The survey sample included 27,308 companies, of which 11,431 responded.

Source: Teikoku Databank, Nomura

Wages (3): 2026 Shunto is Expected to Yield a Base Pay Increase of More Than 3%

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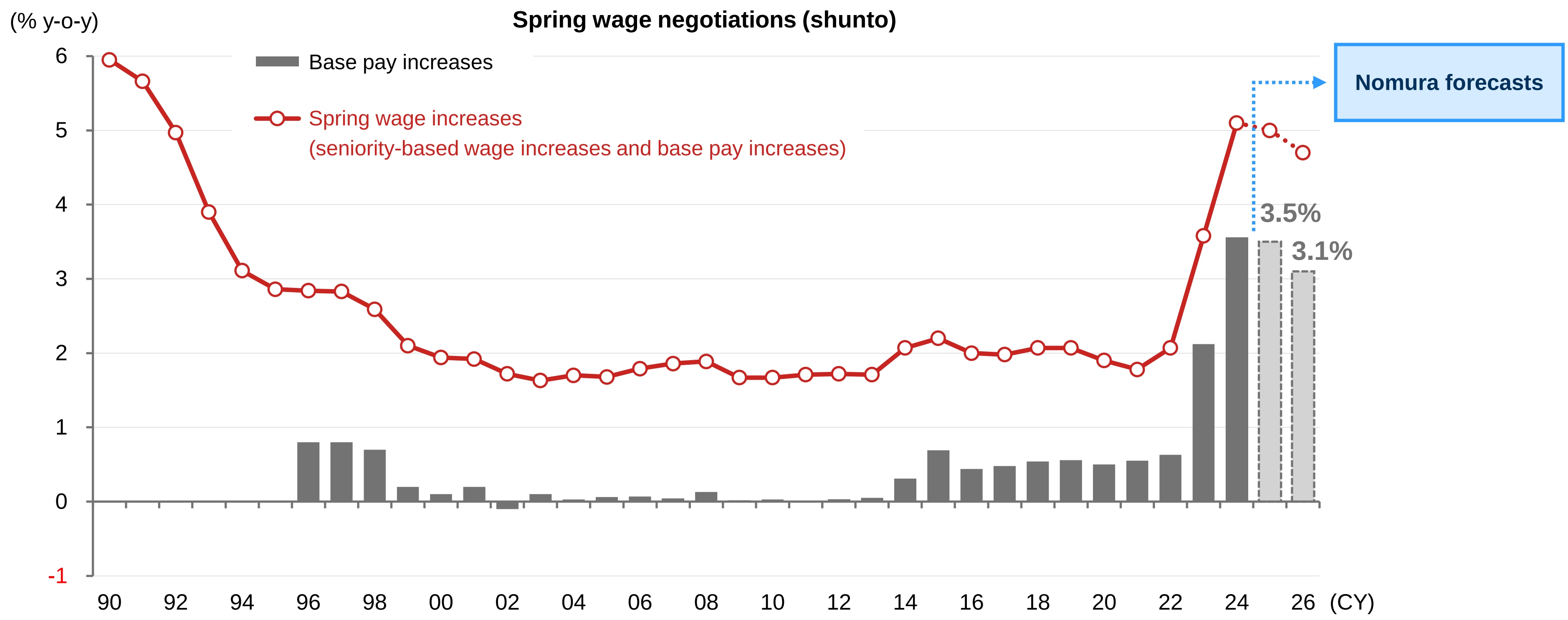
- **In the 2024 shunto, wage hikes (including seniority) were 5.1% with base pay growth of 3.56%.**
- **In the 2025 shunto, we expect wage hikes (including seniority) to be 5.0% with base pay growth of 3.5%.**
- **In the 2026 shunto, we expect wage hikes (including seniority) to be 4.7% with base pay growth of 3.1%.**

2026 shunto (spring wage negotiations) is expected to yield base pay growth of more than 3% (Nomura projection)



Note: 1. Base pay increases are based on surveys by Keidanren (1996-98), Central Labour Relations Commission (1999-2014) and Rengo (2015-24).
2. Data for 2025 and 2026 are Nomura's forecasts.
Source: Japan Trade Union Confederation (Rengo)

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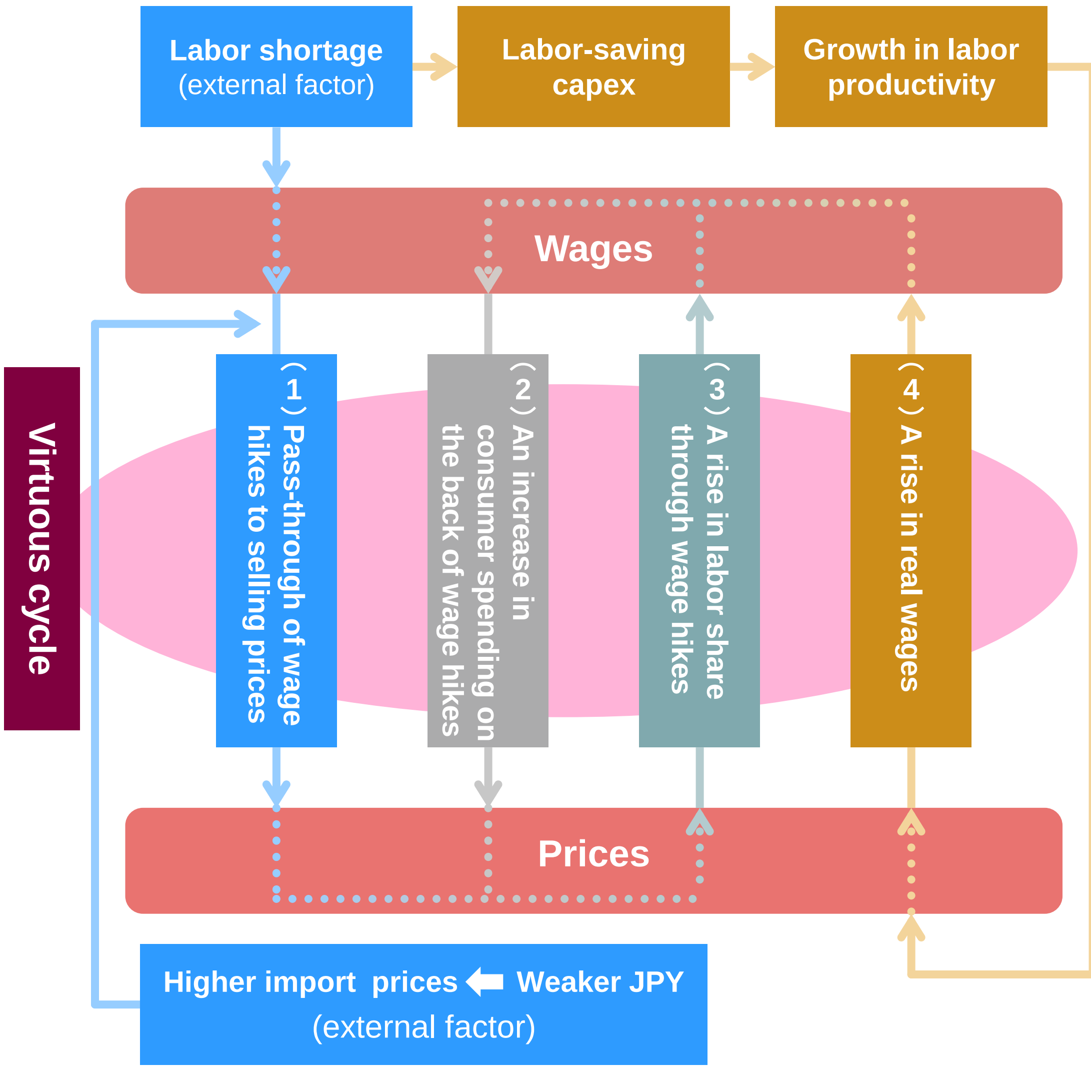
Four major channels for a virtuous cycle between wages and prices



Our assessment

Channel 1 → Gradually working

Channel 2 → Not working

Channel 3 → Gradually working

Channel 4 → Not working

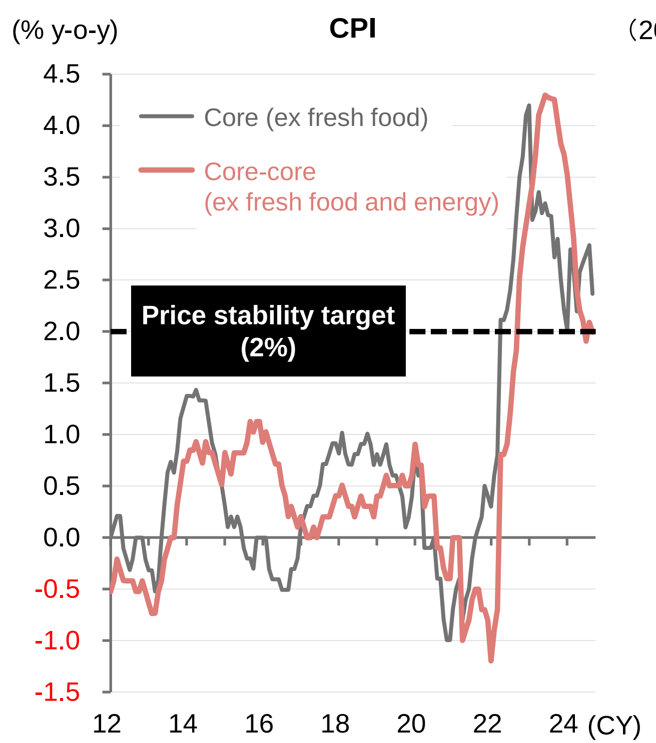
Channels need to expand for the BOJ to be able to reach **the neutral rate of interest**

Source: Nomura

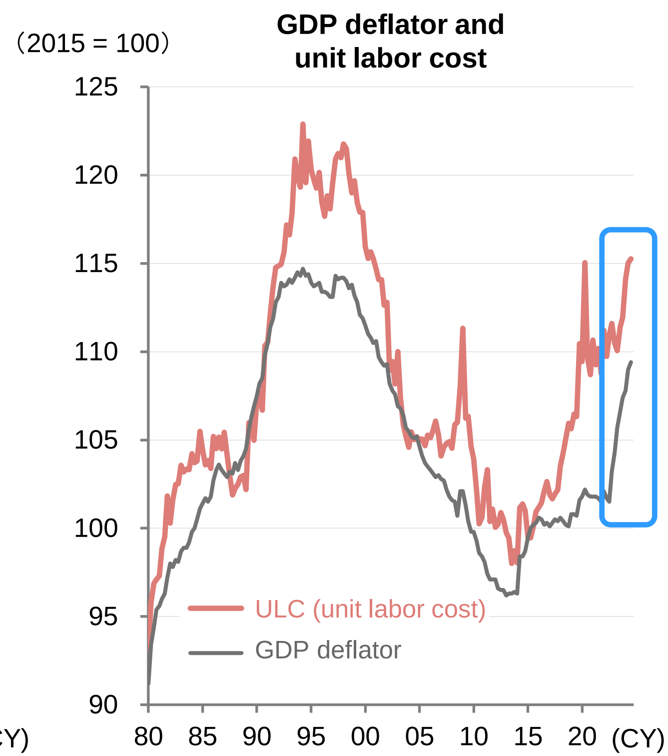
Inflation (1): Positive Trends in the Four Indicators the Government Monitors to Assess Prices

- In March 2006, the Cabinet Office under then-Prime Minister Junichiro Koizumi submitted a report on judging the end of deflation to the Upper House Budget Committee
  ⇒ The report defined a recovery from deflation as a situation where prices are no longer declining continuously and where the economy is unlikely to revert to a continuous decline in prices.
- Four indicators for determining recovery from deflation as defined in the report are 1) CPI, 2) GDP deflator, 3) UC (unit labor cost), and 4) output gap

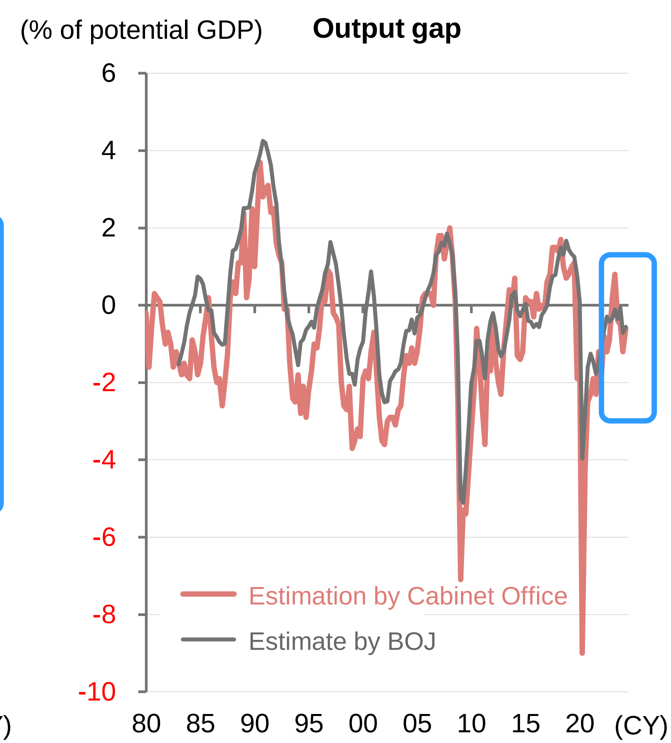
The four indicators (CPI, GDP deflator, unit labor cost, and output gap) are improving



Source: Ministry of Internal Affairs and Communications, Nomura



Note: ULC = nominal compensation of employees / real GDP
Source: Cabinet Office, MIC, Nomura



Note: Output gap = (real GDP - potential GDP) / potential GDP
Source: Cabinet Office, BOJ, Nomura

Inflation (2): Core CPI Inflation Expected to Be Above 2% Toward Mid-2025 and Become More Stable

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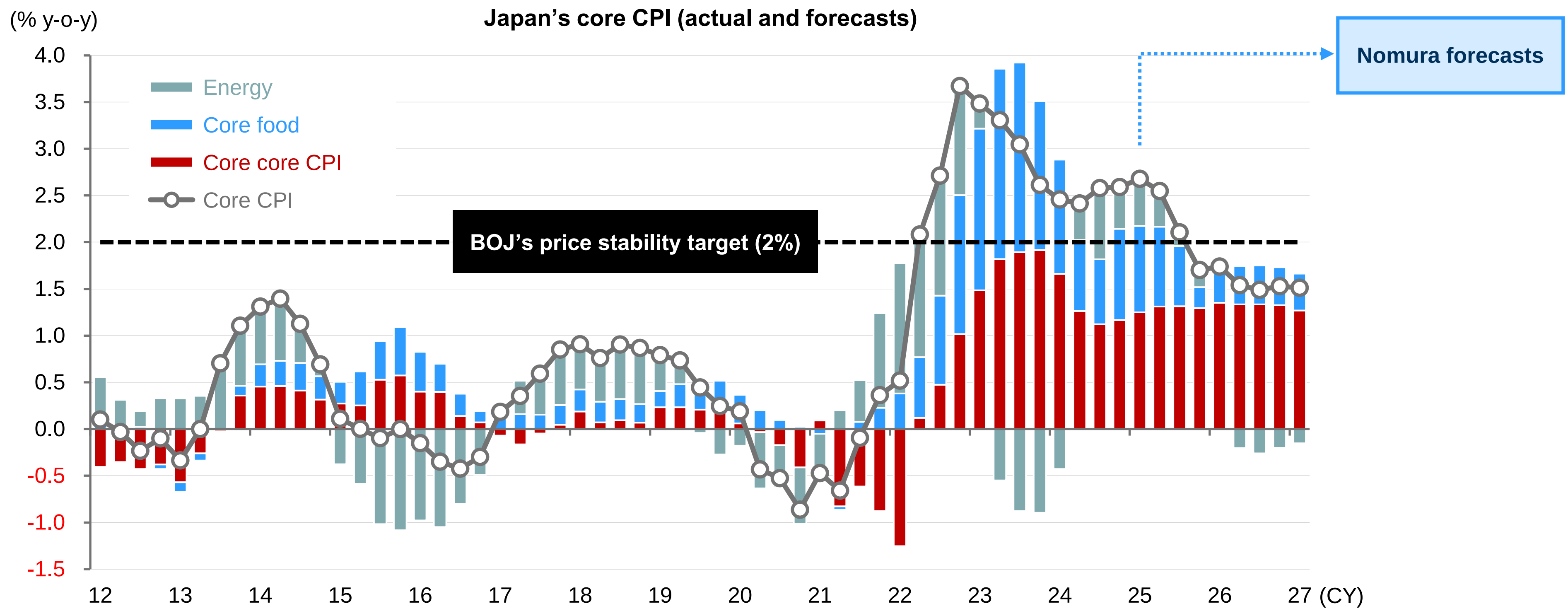
- While food prices continue to comprise a smaller proportion of overall inflation, core CPI (which excludes fresh foods) looks set to remain above 2% through the middle of 2025
- We believe this inflation will turn more “home-made” and increase in stability

CPI inflation looks set to remain above 2% through the middle of 2025 and stabilize even as it slows



Note: Core CPI is overall CPI excluding fresh food. Core core CPI is overall CPI excluding energy and core food (food except fresh food and alcoholic beverages).
Source: Nomura, based on MIC data. Forecasts are by Nomura

BOJ (1):
The Next Rate Increase is Expected in March 2025

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- **At the press conference following the Bank of Japan's Monetary Policy Meeting (MPM) in December 2024, Governor Kazuo Ueda indicated that the BOJ will be more highly attentive to the impact of uncertainties (particularly wage-setting in 2025)**
- **Its stance suggests that the BOJ may even be willing to accept a certain level of weakening of the yen if inflation expectations can be raised with the backing of wage growth**
- **The fundamentals of the Japanese economy are by no means weaker; what has changed is Governor Ueda's stance (there is no change in the fundamentals)**

BOJ Scenarios — Forecast by Nomura

	Main scenario (Probability: 50%)	Risk scenario A (Probability: 30%)	Risk scenario B (Probability: 20%)
● **Number of rate hikes**	▪ Twice in 2025 ▪ Once in 2026	▪ Twice in 2025 ▪ Once in 2026	▪ Twice in 2025 ▪ None in 2026
● **Timing of rate hikes**	▪ March 2025 MPM ▪ October 2025 MPM ▪ March 2026 MPM	▪ January 2025 MPM ▪ July 2025 MPM ▪ January 2026 MPM	▪ April 2025 MPM (Apr. 30-May 1) ▪ October 2025 MPM
● **Policy interest rate**			
▪ Current	0.25%	0.25%	0.25%
▪ End-2025	0.75%	0.75%	0.75%
▪ End-2026	1.00%	1.00%	0.75%

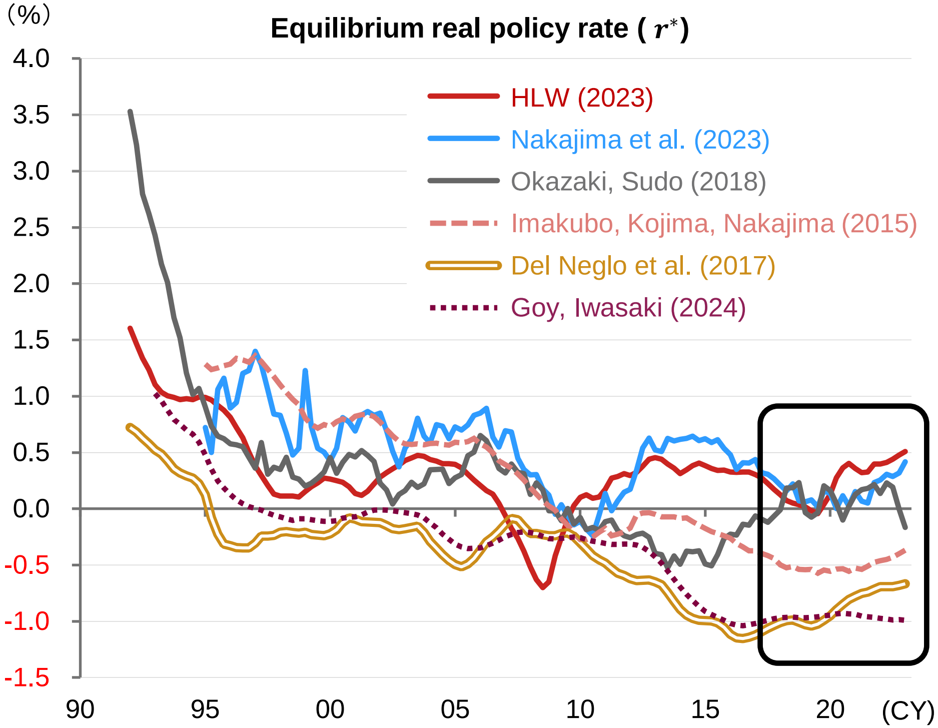
Note: The probabilities of the above scenarios are relative probability distributions for three scenarios with a certain level of possibility, and do not completely exclude the possibility of alternative scenarios

Source: Nomura

BOJ (2): Where does Japan's r^* stand?

- Models suggest Japan's r^* has been gradually rising over the last five years, which gives room for normalization of the BOJ's policy management.
- The lowest estimation of Japan's r^* is about -1%, which translates into a neutral rate (equilibrium nominal policy rate) of 1%, assuming inflation will be anchored around 2%.

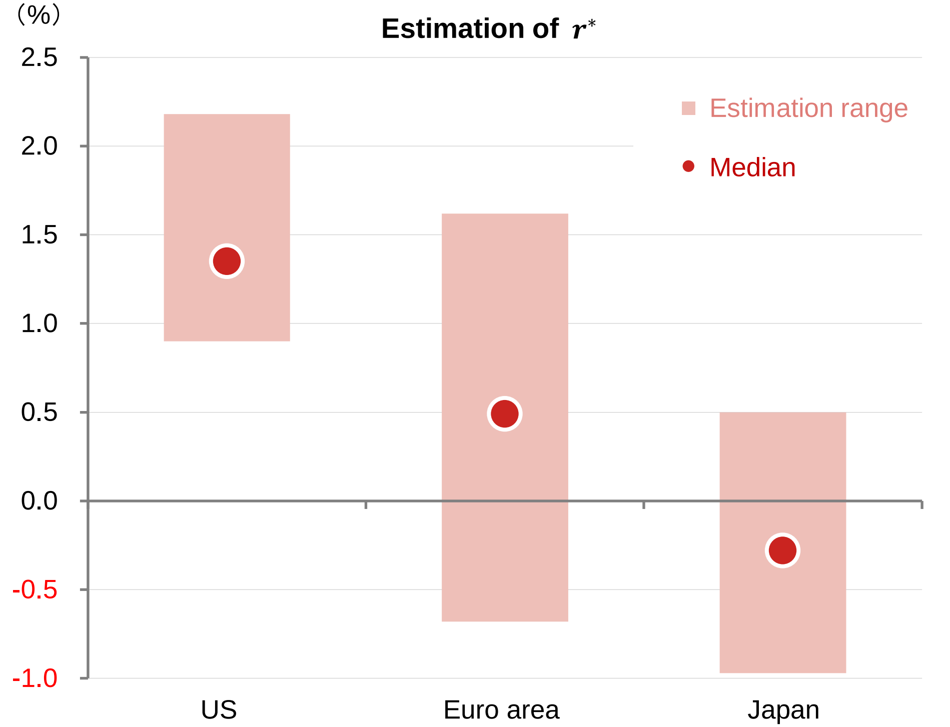
Gradually rising r^*



Note: 1. Based on model presented in Figure 2 of August 2024 Bank of Japan Working Paper Series No. 24-J-9 (available in Japanese) titled Shizen rishiritsu no keisoku wo meguru kinnen no doko ("Recent developments in the measurement of the natural interest rate"), by Yuu Sugioka, Shougo Nakano, and Hiroki Yamamoto.
2. Real policy interest rate = [unsecured overnight call rate] – [y-y change in core-core CPI (excludes fresh food and energy)].

Source: BOJ, Nomura

Japan's r^* lower than that of the US and the euro area



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Source: BOJ, Nomura

BOJ (3): Real policy rate below during NIRP, also lower than r^*

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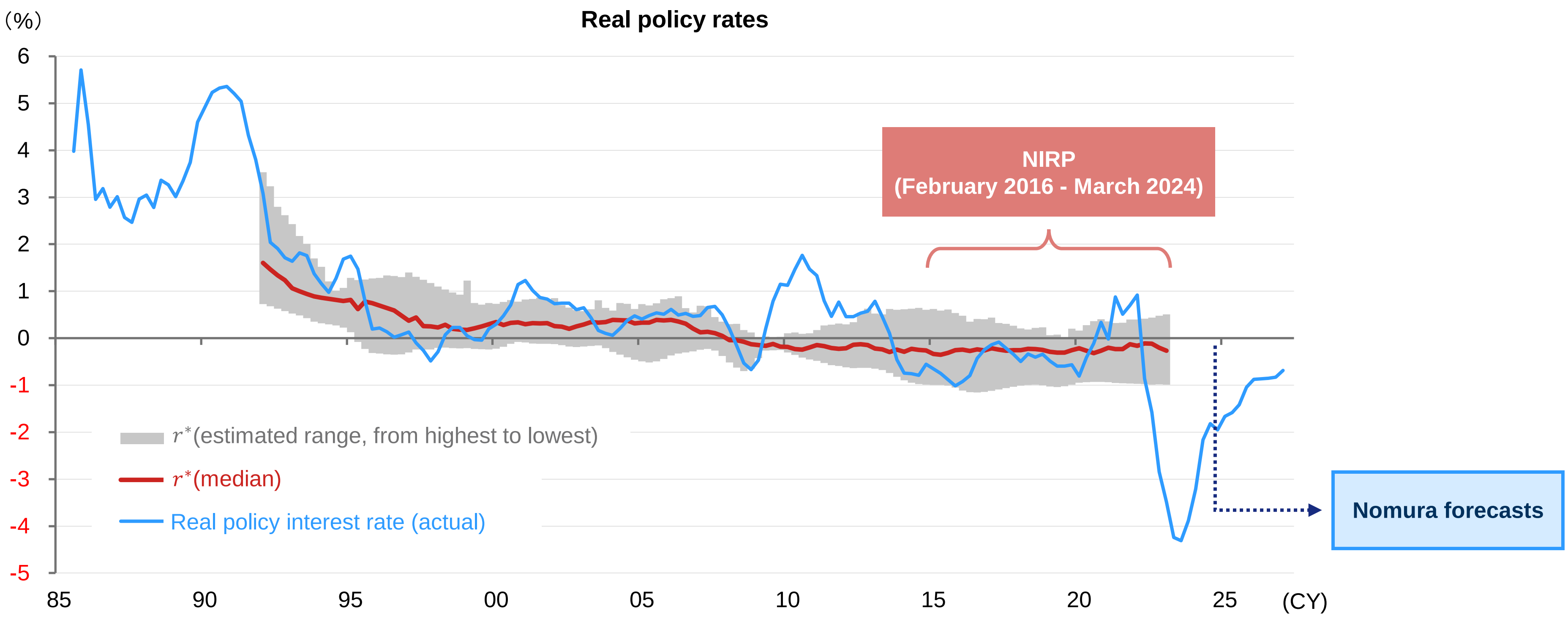
- The real policy rate is lower even than that during the negative interest rate policy (NIRP) period in February 2016 – March 2024.
- The real policy rate is also lower than the median of the estimates of r^* .
- Given these background factors, the BOJ is considering adjusting the extent to which monetary policy is accommodative.

The real policy rate is lower even than that during NIRP



Note: 1. Estimated range and median for r^* (equilibrium real policy rate) are based on model presented in Figure 2 of August 2024 Bank of Japan Working Paper Series No. 24-J-9 (available in Japanese) titled Shizen rishiritsu no keisoku wo meguru kinnen no doko ("Recent developments in the measurement of the natural interest rate"), by Yuu Sugioka, Shougo Nakano, and Hiroki Yamamoto.
2. Real policy interest rate = [unsecured overnight call rate] – [y-y change in core-core CPI (excludes fresh food and energy)]. 3. Real policy interest rates for Jul–Sep 2024 onward are Nomura forecasts.

Source: BOJ, Nomura

Revisit Japan:
The Country May Finally Emerge From Its Slumber

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- **Demographic forces and market pressure may drive structural changes and awaken Japan's economy and businesses from their slumber**
- **The economy could see various improvements, such as (1) higher labor mobility, (2) capex in labor-saving initiatives, (3) more efficient use of capital stock and labor, and (4) long-term wage growth**
  ⇒ Intense interest in how Japan's economy will evolve over the medium to long term

Sources of structural change, five "alarm clocks," and expected benefits

Sources of structural change	Five "alarm clocks"
1. Demographic Forces (low birthrates and aging society; population decline)	1. **Sharp decline in population 15 and older** since 2021
	2. **Reduced scope for women and the elderly to provide new labor supply**
	3. Increased pressure for **business succession**
2. Pressures from markets	4. TSE's request for measures to **address P/B multiples below 1x**
	5. Wider scope of investors monitoring companies as a result of **new Nippon Individual Saving Accounts (NISA) system and moves to eliminate cross-shareholdings**

Expected benefits
1. Long-term **upward pressure on wages** 2. More mobile labor force 3. Longer-term growth in **capex aimed at labor-saving**
4. **More efficient use** of labor, capital stock, and land through redistribution
5. **More efficient use** of capital stock

Source: Nomura

Author Biography

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Kyohei Morita
Chief Economist

As Nomura's Chief Economist, Kyohei Morita analyzes macroeconomic trends across countries and regions, and financial markets across asset classes, to predict what lies ahead for Japan's economy. He is particularly well-versed in monetary policy, having written on the subject for his doctoral thesis; he received his PhD in Economics from Kyushu University in 2018.

Since joining Nomura Research Institute in 1994, he has been engaged in macroeconomic analysis and forecasting. He was at the UK head office of Nomura Research Institute Europe from 2001 to 2004, providing in-depth analysis and forecasts of the Japanese economy for Japanese equities investors in the UK, continental Europe, and the Middle East. During this period, he had opportunities to visit some 500 investors each year. Over the next 14 years, he served as Chief Economist at Barclays Securities (2008-2017) and Credit Agricole (2017-2022). He became Chief Economist at Nomura Securities in 2022.

After graduating from Kyushu University School of Economics in 1994, Kyohei continued his studies at the Graduate School of Brown University from 1998-2000, earning a Master's Degree in Economics. As non-traditional monetary policy came to be adopted around the world, he began work on a doctoral thesis to deepen his understanding of the theoretical and historical underpinnings, culminating in "A Consideration of Monetary Policies Under Low Natural Interest Rates." He received his doctoral degree in economics from Kyushu University in 2018.

As an economist, Kyohei focuses on (1) data analysis that is detailed but easy to understand, (2) generating global, rather than local, economic scenarios, and (3) central bank watching based on meticulous data analysis. Institutional investors have appreciated his insights: thanks to their votes, Kyohei placed second among economists ranked by Nikkei Veritas in 2024.

Kyohei has also contributed to books on economic issues: Asset Formation in an Age of Population Decline (Toyo Keizai, 2005) and Modern Financial Theory, new ed. (Yuhikaku, 2016). He is a frequent guest on the TV Tokyo program, News Morning Satellite, and contributes regularly to Deep Dive into Market Topics by Top Economic Analysts on Diamond Online

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when we work together towards a common goal.

By combining our expertise and that of our partners,
we aim to accelerate the drive towards a sustainable world and
help create an affluent society for all.